COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN ADJUSTMENT OF RATES OF EQUITABLE GAS COMPANY, INC.	))	CASE NO. 92-326

O R D E R

On September 16, 1992, Equitable Gas Company, Inc. filed an application with the Commission requesting authority to increase its gas rates for service rendered on and after October 16, 1992 for customers served by its Kentucky Division. The proposed rates would increase annual gas revenues by $224,877, an increase of approximately 12.38 percent on normalized test-year sales. This Order grants an increase in annual gas revenues of $200,967, an increase of 11.06 percent based on normalized test-year sales, and results in Total Operating Revenues of $2,017,501.

Equitable Gas Company, Inc., a subsidiary of Equitable Resources, Inc., distributes natural gas in Pennsylvania, West Virginia, and Kentucky. The Kentucky Division of Equitable Gas Company, Inc. ("Equitable") provides natural gas service to approximately 4,300 customers in eastern Kentucky pursuant to KRS 278.485 as a farm tap supplier through lines owned by Kentucky West Virginia Pipeline Company, Inc. which is also a subsidiary of Equitable Resources, Inc.

The Commission granted motions to intervene filed by the Attorney General, by and through his Utility and Rate Intervention Division ("AG"); Willard Fleming; John Cleveland; and Artie Ann

Bates. The Commission suspended the proposed rate increase up to and including March 15, 1993 in order to conduct an investigation into the reasonableness of the proposed rates. Equitable filed direct testimony into the record of this proceeding on October 9, 1992. No other party filed direct testimony. A public hearing was held in the Commission's offices in Frankfort, Kentucky, on February 4, 1993 with the AG and John Cleveland present. Briefs were filed by Equitable Gas Co., Inc., the AG, and by John Cleveland and Artie Ann Bates.

On March 15, 1993, Equitable gave notice of intent to place its proposed rates into effect on and after March 16, 1993. The notice was made pursuant to KRS 278.190(2). The Commission was unable to complete its investigation within the suspension period and Equitable complied with the statutory provisions to place the proposed rates into effect. After consideration of the record and being otherwise sufficiently advised, the Commission grants a rate increase of $200,967 based upon the following:

TEST PERIOD

Equitable proposed the 12-month period ended June 30, 1992 as the test period for determining the reasonableness of the proposed rates, which the Commission finds to be reasonable. In utilizing the historic test period, the Commission has given full consideration to appropriate known and measurable changes.

NET ORIGINAL COST RATE BASE

Equitable proposed a net original cost rate base of $534,515. Equitable calculated the rate base using test-year-end plant levels, plus completed construction not yet classified, plus a 12.5 percent working capital allowance. Equitable reduced the rate base by the total amount of Deferred Investment Tax Credit and Deferred Income Taxes. The Commission accepts Equitable's methodology with the exception of the following.

Cash Working Capital Allowance

Equitable determined the cash working capital allowance using the 45 day or 1/8 formula methodology. The Commission accepts this methodology and has adjusted the allowance for cash working capital to reflect the accepted pro forma adjustments to operations and maintenance expenses found reasonable herein.

In determining the cash working capital allowance, Equitable deducted from the operation and maintenance expenses the gas supply expenses and uncollectible accounts expense for the test year. The Commission concurs with the deduction of gas supply expenses. However, the Commission does not concur with the deduction of the uncollectible accounts expense from the reasonable level of operating expenses used in developing a Working Capital Allowance. Uncollectible account expenses represent a negative cash receipt and should, therefore, be recognized in the provision for cash working capital.

Based upon the previous findings, we have determined the net original cost rate base for Equitable at June 30, 1992 to be $534,184 determined as follows:

	TOTAL
Gas Plant In Service:	
Distribution plant	$ 470,136
Add:	
Completed Plant not yet classified	144,495
Cash Working Capital	63,793
Deduct:	
Reserve for Depreciation	48,849
Accumulated Deferred Income Taxes	71,739
Investment Tax Credit	23,652
Net Original Cost Rate Base	$ 534,184

REVENUES AND EXPENSES

For the test period, Equitable had an actual net operating loss of $189,857.[1] Equitable proposed several pro forma adjustments to revenues and expenses to reflect more current and anticipated operating conditions, resulting in an adjusted net operating income of $56,124. After filing this rate case, Equitable brought several adjustments to the attention of the Commission. However, Equitable did not propose that these adjustments be incorporated into its rate request and the Commission has not done so. The Commission has reviewed the entire record in this case and finds the original adjustments proposed by Equitable are acceptable for rate-making purposes with the following modifications.

[1] Application, Statement D, sheet 1 of 5.

Normalized Revenues

Equitable proposed normalized revenues in the amount of $1,816,534. This figure was calculated by pricing test-year sales volumes of 502,541 Mcf at retail rates in effect at the time of the filing of Equitable's rate application, and adding in 12 months of customer charges and test-year Miscellaneous Revenues. Equitable's proposal is reasonable and results in an adjustment to test-year revenues in the amount of ($544,133).

Purchased Gas Expenses

Equitable proposed an adjustment to test-year purchased gas expense of ($730,881), to arrive at normalized purchased gas expense of $1,367,917. The normalized figure was calculated by applying the gas cost recovery rate in effect at the time of Equitable's filing of its application to test-year sales volumes.[2] This is reasonable and should be approved as proposed by Equitable.

Labor and Labor-Related Costs

Equitable proposed three adjustments to increase the test-year operating expenses by $19,362 for labor and labor-related costs. The proposed adjustment items were an increase of $15,072 to Wages and Salaries, an increase of $2,908 to Pensions and Benefits, and an increase of $1,382 to Payroll Taxes.

Wages and Salaries. Equitable's proposed increase of $15,072 reflects the allocation of wage and salary increases which were granted during the test year as well as after the end of the test

[2] Case No. 89-286-H, The Notice of Purchased Gas Adjustment Filing of Equitable Gas Company, Order dated May 1, 1992.

year. Allocations of this cost are necessary since Equitable does not maintain separate books of account for its cost elements for Kentucky operations. John Cleveland and Artie Ann Bates argued that a charge of approximately $15 per hour was excessive for meter readers. The AG argues that the total meter reading expenses of Equitable are inordinately high in comparison with various gas distribution companies around the state. However, after review we find that expenses included in the meter reading expense account by Equitable include certain expenses that would be recorded in other accounts by the distribution companies used in the AG's comparisons. These expenses include transportation expenses, maintenance, utilities, and tools and fixtures. In addition, as the AG acknowledges, Equitable provides farm tap service pursuant to KRS 278.485 and is not considered by this Commission to be comparable to a local distribution company.

The Commission finds reasonable Equitable's proposed adjustment to wages and salaries, except for the inclusion of wage and salary increases beyond the end of the test year. The proposed increases ranged from 2 to 4 months after the end of the test year. It is inappropriate to include one post test-year cost change in isolation from other changes, such as productivity increases, that may have taken place since the end of the test year. The Commission, therefore, has normalized test-year-end wages and salaries according to the methodology proposed by Equitable but only for those increases occurring during the test year. This results in an increase of $2,896 to Equitable's test-year wage and salary expense of $293,954, or $296,850.

Labor-Related Costs. Equitable Gas Company, Inc. allocates to Kentucky jurisdictional operations the labor-related costs of pensions and benefits and payroll taxes based on the total level of the labor costs allocated to its Kentucky operations. The Commission concurs with this methodology and has calculated labor-related costs on the level of wages and salaries found reasonable herein. This methodology results in an increase of $576 for pensions and benefits expense and an increase of $831 for payroll taxes.

Regulatory Commission Expense

Equitable proposed to increase test-year actual regulatory Commission expense of $904 by $2,696 to $3,600 to reflect amortization of an estimated rate case expense of $10,800 over a 3 year period. In its September 23, 1992 Order, the Commission directed Equitable to provide monthly updates of its actual costs incurred in connection with this rate case. This information was also requested at the hearing but to date this information has not been provided. Equitable has filed into the record limited support for only $12 of in-house labor costs related to this adjustment.[3] It is inappropriate to include the estimated expense level in rates without documentation or other support. Therefore, the Commission

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[3] Response to the Commission's Order dated September 23, 1992, Item 10.

has not included the estimated expense level of $3,600 in the adjusted test-year expenses.

Income Taxes

Equitable proposed two separate adjustments to the test-year income tax expense of ($122,000). The first adjustment totalled $57,168 and reflected the effects of Equitable's proposed adjustments and normalizations on the test year based on a blended federal and state income tax rate of 38.665 percent. The adjustments resulted in a ($64,832) income tax expense for the test year. Equitable proposed to further increase income tax expense by $82,631 to reflect the income tax effect on its proposed increase of $224,876.

The Commission has used a blended tax rate of 36.96 percent which more accurately reflects the level of expense Equitable can expect to pay at the net operating income level found reasonable herein. Using this blended rate results in an income tax loss of $55,512 on the adjusted test year before the tax effects of the revenue increase granted in this case. Applying the blended rate of 36.96 percent to the revenue increase results in an increase of $73,615 to the adjusted test-year income tax expense. These adjustments result in an adjusted and normalized expense level of $18,103 for the test year.

Uncollectible Accounts

Equitable proposed to increase uncollectible accounts expense by $2,024 to reflect the effects of the historic .9 percent level of uncollectible accounts expense on the company's proposed revenue increase of $224,876. The Commission concurs with this methodology and has applied the historic .9 percent level of uncollectibles on the revenue increase granted by this order. This results in a $1,793 increase to the $20,936 test-year actual level of expense.

The adjusted net operating income is as follows:

Operating Revenues	$1,816,534
Operating Expenses	1,890,904
Adjusted Net Operating Income	$ (74,370)

RATE OF RETURN

Capital Structure and Cost of Debt

Equitable proposed a capital structure based on the actual capital structure of Equitable Gas Company, Inc. at June 30, 1992. The proposed capital structure consists of 47.4 percent long-term debt and 52.6 percent common equity. Equitable determined its overall embedded cost of debt to be 8.01 percent. This includes the use of short-term intercompany notes at a cost of 4.313 percent during the test year. The Commission accepts Equitable's proposed capital structure and cost of debt.

Return on Equity

Equitable proposed a return on common equity of 12.75 percent. In order to minimize the rate case expense and alleviate any unnecessary rate burden to Equitable's retail customers, the proposed return was simply the same as that proposed by Equitable-Pennsylvania in its most recent case.[4] Equitable-Pennsylvania is

[4] Testimony of S. F. Piskurich, page 5.

a local distribution company that serves 247,322 residential, commercial, industrial, contract sales and transportation customers. Equitable is a supplier of farm tap service pursuant to KRS 278.485 to an almost exclusively residential load of 4,296 customers. The Commission recently affirmed Equitable's status as a farm tap system,[5] yet the Kentucky division has elected full rate base regulation by this Commission as though it were a local distribution utility.

Mr. Cleveland expressed concern about the reasonableness of Equitable's proposed return as the best return he is able to obtain on a checking/savings account is in the range of 3.0 to 4.0 percent.[6]

The Commission is bound by the standards set forth in The Federal Power Commission v. Hope Natural Gas Company, 320 U.S. 591, 64 S.Ct. 281, 88 L. Ed 333 (1944) and Bluefield Waterworks and Improvement Company v. Public Service Commission, West Virginia, 262 U.S. 679 67 L. Ed 1176, P.V.R. 1923 D 11 (1923) to allow Equitable a return commensurate with returns on other investments in other businesses with corresponding risk, sufficient to support its credit and enable it to attract new capital. However, the return proposed for Equitable-Pennsylvania is not an appropriate return for the Kentucky operating division.

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5 Case No. 92-168, An Investigation Into Equitable Gas Company's Status As A Provider Of Farm Tap Service, Order dated February 8, 1993.

6 T.E., page 60.

The Commission, having considered all the evidence, including current economic conditions, finds that the cost of common equity is within a range of 10.75 to 11.25 percent. Within this range, a return of 11.0 percent will best allow Equitable to attract capital at a reasonable cost and maintain its financial integrity to ensure continued service and provide for necessary expansion to meet future requirements pursuant to KRS 278.485.

Rate of Return Summary

Applying the rates of 8.01 percent for debt and the 11.0 percent for common equity to the capital structure produces an overall cost of capital of 9.58 percent, which we find to be fair, just, and reasonable. Applying this return to the $534,184 rate base found reasonable herein results in an allowable net operating income of $51,175. To achieve this level of income requires additional revenues of $200,967.

Rate Design and Rates

Equitable proposed no change in its rate design. It did, however, propose to increase its customer charge by 62.5 percent to recover increases in meter reading expenses. An increase of this magnitude in fixed monthly charges to customers of a "farm-tap" system, who have no statutory guarantee of continued service or quality of gas, is inappropriate. It appears reasonable to increase the customer charge in order to stabilize the collection of revenue, but by no more than the percentage amount of the overall increase granted. The customer charge should be increased approximately 11.06 percent, to $4.45. This will produce revenues in the amount of $229,945. The remainder of Equitable's revenue requirement should likewise be collected by increasing all rates for Mcf sales by approximately 11.06 percent. Equitable provided no cost-of-service study to support its proposed cost-of-service-based allocation of increase to rate blocks. Equitable's approved rates for service should be:

Customer Charge	$4.45
For the first 2 Mcf used per month	$3.7619
For the next 18 Mcf used per month	$3.5398
For the next 30 Mcf used per month	$3.4399
For the next 50 Mcf used per month	$3.3510
All over 100 Mcf used per month	$3.2733

These rates include the Gas Cost Recovery rate in effect June 30, 1992. The rates contained in the Appendix to this Order are adjusted to reflect changes in the Gas Cost Recovery rate up to and including that approved effective February 1, 1993.

IT IS THEREFORE ORDERED that:

1. The rates and charges proposed by Equitable be and they hereby are denied.

2. The rates in the Appendix, which is attached hereto and incorporated herein, be and they hereby are fair, just and reasonable rates to be charged by Equitable for service rendered on and after March 15, 1993.

3. Within 30 days from the date of this Order, Equitable shall file with the Commission revised tariff sheets setting out the rate and tariff changes approved herein.

4. Within 30 days of the date of this Order, Equitable shall file with this Commission the amount of excess revenues

collected through the March 16, 1993 implementation of its proposed rates along with a refund plan. The refund plan shall be calculated pursuant to KRS 278.190(4) and shall include interest at a rate equal to the average of the "3-Month Commercial Paper Rate." These rates are reported in the Federal Reserve Bulletin and the Federal Reserve Statistical Release.

5. Within 20 days of the completion of the refund period, Equitable shall certify to this Commission that the overcollections have been refunded to its customers pursuant to its refund plan.

Done at Frankfort, Kentucky, this 12th day of April, 1993.

PUBLIC SERVICE COMMISSION

Chairman

Vice Chairman

Commissioner

ATTEST:

Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 92-326 DATED April 12, 1993.

The following rates and charges are prescribed for the customers in the area served by Equitable Gas Company. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the date of this Order.

RATES: Monthly

Customer Charge $4.45

		Base Rate	Gas Cost Recovery Rate	Total Rate
First	2 Mcf	$1.0399	$3.6899	$4.7298 per Mcf
Next	18 Mcf	0.8178	3.6899	4.5077 per Mcf
Next	30 Mcf	0.7179	3.6899	4.4078 per Mcf
Next	50 Mcf	0.6290	3.6899	4.3189 per Mcf
All Over	100 Mcf	0.5513	3.6899	4.2412 per Mcf

The minimum bill shall be $4.45.

The following adjustments will be made to the above rates:

A surcharge of $0.2278 per Mcf to reconcile under-collections occurring from 4/1/83 to 6/30/87 will be added to the above rates to be effective for 60 months beginning with the date of the Commission Order in Case No. 6602-GG or until the undercollection is recovered.